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FROM AMBASSADOR HUME TO EEB A/S SULLIVAN

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [ENRG](#) [KCOR](#) [PGOV](#) [ID](#)  
SUBJECT: SCENESETTER FOR EEB A/S SULLIVAN VISIT TO JAKARTA

**¶1.** (SBU) Summary. Embassy Jakarta welcomes you to Indonesia. Yours will be the first high-level State Department economic visit here in several years. We encourage you to make a strong pitch for OPIC to facilitate U.S. investment, for exploratory discussion of a Bilateral Investment Treaty (BIT), and for the Government of Indonesia (GOI) to do more to open its markets to foreign investment and enhance its competitiveness. We also recommend you encourage the GOI to streamline its asset-freezing process under UN 1267. End Summary

BATAM ISLAND-YOUR FIRST STOP

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**¶2.** (SBU) Your visit to Indonesia's Batam Island, 12 miles south of Singapore, will give you insight into how the GOI uses "Special Economic Zones" (SEZs), to "fast track" investment reforms. SEZs allow duty free trade within select areas. Despite these advantages, Batam's investment potential has been constrained by regulatory uncertainty and local economic factors. The 2006 Indonesia-Singapore "Framework Agreement on Economic Cooperation" focuses on developing Batam and extending SEZ status to adjacent islands. Batam hosts several USG-assisted GOI initiatives including the Customs Office "National Single Window Pilot Project" and Indonesia's Investment Board's (BKPM) "One Stop Service Promotion Center." In your conversations with government and business leaders we encourage you to inquire about the status and effectiveness of both these programs.

**¶3.** (SBU) USTR has also offered assistance in developing Indonesian SEZ's under the U.S.-Indonesian Trade and Investment Framework Agreement" (TIFA), which would serve as an effective counterweight to Singapore's increasing influence over the region. Your visit provides an opportunity to assess the openness of local officials to such a proposal. Joe Bartlett, President of the AmCham, and Economics Officer Jonathan Alan will accompany you during your visit to Batam.

MACROECONOMICS NOT BAD

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**¶4.** (SBU) With growth of 6.0% in the first quarter (5.5% for 2006), high reserves, robust capital flows and dynamic trade, Indonesia's macroeconomy is growing briskly, but still below the 6.6% growth necessary to impact unemployment and alleviate poverty. Investment though is slow; Indonesia is still regarded as corrupt and over-regulated by investors, with inefficient state-owned enterprises monopolizing key sectors and a complex licensing regime.

OPIC - Still Stuck

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**¶5.** (SBU) The GOI does not have an updated OPIC agreement clarifying the Foreign Government Approval ("FGA") process. As a result, OPIC has been unable to obtain timely approvals for investment projects. OPIC has received more than \$600 million of investment inquiries for

Indonesia in last 12 months. We recommend you raise this issue in your meetings with the Investment Coordinating Board (BKPM), the Ministry of Finance and the Ministry of Trade.

Investment, BIT and Negative List

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¶16. (SBU) Indonesia's newly-revised negative list for foreign investment was issued on July 4. While investors may benefit from the increased transparency and legal certainty, some new investment limits are now officially lower than the upper limit of what was previously allowed. GOI has stated the new list will not be applied retroactively. We encourage you to remind GOI officials that increased or sustained restrictions send the wrong signal and undermine GOI's goal of increasing Foreign Direct Investment.

Bilateral Investment Treaty

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¶17. (SBU) USTR has proposed to GOI Ministry of Trade (MOT) to begin exploratory talks on negotiating a Bilateral Investment Treaty (BIT); the GOI has not yet responded. We encourage you to highlight the importance and benefits of a BIT, and to urge the GOI to begin an exploratory dialogue. We also welcome Indonesia's comments on our model BIT text.

Corruption's Toll and the Judiciary

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¶18. (SBU) Indonesia's corruption hinders trade of goods, adding an estimated 20% or more to business costs, and foreign investors continue to complain about the dysfunctional judiciary. An American citizen executive of the U.S.-based company Newmont Mining remains entangled in a legal battle with GOI despite overwhelming

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exculpatory evidence and an acquittal by a district court. Prosecutors (in violation of Indonesia's own criminal code), have appealed the acquittal to the Supreme Court, which has the power to impose a jail sentence. We encourage you to remind GOI officials the chilling effect cases like this have on future foreign investment.

Millennium Challenge Threshold Program

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¶19. (SBU) USAID and GOI signed a \$55 million agreement in November 2006 for a Millennium Challenge Corporation (MCC) Threshold Program, managed by USAID. The program includes a \$35 million Control of Corruption component that will address Supreme Court reforms, judicial transparency, anti-money laundering enforcement and prosecution of public corruption cases. The program will run from 2007 - 2009. You may wish to congratulate Indonesia on its MCC program and the contribution it will make to combat corruption.

Bilateral Energy Dialogue and Biofuels

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¶10. (SBU) Our bilateral Energy Policy Dialogue (EPD) is re-energized. Our next meeting is tentatively planned for fall 2007 in Indonesia. The GOI is continuing its ambitious five-year, multi-billion dollar investment plan to boost biofuel production. The GOI has announced sensible biofuel policies, including a \$108 million fund to create incentives for biofuels investments and \$1.08 billion to improve agricultural and rural infrastructure. The GOI has also signed 58 tentative agreements reportedly worth \$12 billion with foreign and domestic investors (mostly Chinese, Japanese, and Malaysian firms). The GOI's biofuel initiative appears to be here to stay, although at current prices for feedstock, Indonesian biofuel remains uneconomic.

Asset Freezing

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¶11. (SBU) Indonesia does not have a streamlined process to implement

asset-freezing obligations of Al-Qaeda-related individuals and entities under UN 1267. Commercial bank compliance officers complain that even when they receive timely asset-freezing orders from GOI, the similarity of names and addresses in Indonesia make it difficult to locate assets. Bank of Indonesia's (BI) credit bureau is also a work in progress, with many borrowers not listed in the database and commercial banks worried about data security. We encourage you in your meeting with BI to raise the issue of a more streamlined process for asset freezing under Indonesia's UN obligations.

#### IPR - Steady Progress, More Prosecutions Needed

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**¶12.** (SBU) The largest and most successful IPR raid ever in Indonesia occurred on July 1 when Indonesian law enforcement raided two factories suspected of producing pirated optical disks. While impressive, sustained efforts are essential to avoid Indonesia's return to the Priority Watch List. GOI needs to demonstrate success in prosecuting not only working-level employees, but factory owners as well. We suggest congratulating GOI officials on their success, and encouraging continued efforts by emphasizing the economic advantages of a strong IPR regime.

#### Tropical Forest Conservation Act

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**¶13.** (U) GOI is eligible \$19.6 million of "debt redirection" under the Tropical Forest Conservation Act (TFCA) debt-for-nature program. GOI is also hosting the UN Climate Change conference in Bali December 3-14, which will draw attention to Indonesia's record as the world's third largest producer of carbon emissions due to deforestation. GOI is keen for solutions to deforestation, annual haze and biodiversity loss. In your meeting with Ministry of Finance officials you could encourage GOI to take full advantage of the TFCA opportunity.

#### The U.S and ASEAN: Losing Influence?

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**¶14.** (SBU) Our engagement with ASEAN remains robust; however lack of U.S. participation at several recent key ASEAN events has caused a loss of momentum. Meanwhile China continues to exert influence. In your meetings with GOI officials the general message that "the U.S. cares" about ASEAN would be helpful. Indonesia is also the country coordinator for ASEAN-US economic cooperation. However, the MOT has been slow to cooperate with USTR on initiatives. We suggest informing GOI officials that the U.S. is interested to move more briskly in expanding our economic cooperation with ASEAN, and would appreciate MOT's responsiveness.

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#### Economic Education

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**¶15.** (U) Indonesia's higher education system is underdeveloped. Many students with means choose to attend graduate school abroad. Indonesia has only 10,000 PhDs despite a population of 240 million. English is not as widely taught as in other developing countries. Indonesia's premier school for economics is the University of Indonesia (UI); many senior GOI leaders rank among the alumni.

#### Media

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**¶16.** (U) Indonesia's media is lively, but more oriented toward news and opinion than investigation and analysis. Press freedom is still developing, and in-depth, authoritative business and economics reporting is weak, superficial and often tinged with nationalism. Many in Indonesia do not read, and get their information primarily from TV. Affluent Indonesians have access to wide range of foreign cable TV channels, including CNBC, CNN, Fox and BBC.

¶17. (SBU) Journalists may ask why U.S. investment in Indonesia remains slow. You may get questions on climate change: how U.S. climate change and other environmental policies are linked to big corporations; how the U.S. is doing in its struggle to find alternative sources of energy. What is our policy on biofuels? How could bilateral biofuel cooperation increase? You may also get questions on the influence of U.S. drug, software and entertainment companies on IPR policy, or avian influenza sample-sharing. How does the U.S. assess IPR progress in Indonesia? What is the U.S. doing to help Indonesia on air safety? Will Indonesia be considered for MCC Compact Status this year? Also, there could be questions about superpower competition from emerging economic powers China and India.

#### Civil Aviation Safety Problems

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¶18. (SBU) Indonesia suffered several serious civil aviation accidents in early 2007, leading to an FAA Category 2 downgrade, EU blacklisting, and negative media coverage. The FAA recently finished a Technical Review of the Indonesian civil aviation authorities at the request of the GOI to help identify aviation safety issues and solutions.

Indonesia represents over \$3 billion in current Boeing aircraft orders. The CEO of Lion Air, the main purchaser of the Boeings, has been invited to the dinner scheduled on July 25.

#### Port Security

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¶19. (SBU) A U.S. Coast Guard (USCG) inspection has found Indonesia not compliant with the International Ship and Port Facility Security (ISPS) code. USCG will release a demarche giving Indonesia 90 days to comply or face a Port Security Advisory (PSA). A PSA places added security costs and increases delays on ships entering U.S. ports subsequent to docking at Indonesian ports, and would significantly impact Indonesia-US maritime trade.

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